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Viewing cable 09BUENOSAIRES66, ARGENTINA: CENTRAL BANK PRESIDENT DEFENDS

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Reference ID	Created	Released	Classification	Origin
09BUENOSAIRES66	2009-01-21 19:23	2011-08-30 01:44	CONFIDENTIAL	Embassy Buenos Aires

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SUBJECT: ARGENTINA: CENTRAL BANK PRESIDENT DEFENDS
INSTITUTIONAL INDEPENDENCE

REF: A. '08 BUENOS AIRES 1491
[1](#)B. '08 BUENOS AIRES 1389

Classified By: Amb. E.A. Wayne. Reasons 1.4 (B,D)

Summary

1. (C) Central Bank (BCRA) President Martin Redrado emphasized his success maintaining relative market confidence in the Argentine Peso in the face of four major financial crises since August 2007. In a January 16 meeting with Ambassador, he discounted market expectations of a large depreciation this year, arguing that the fate of the Peso depends on numerous factors, including Dollar and Euro values, global interest rates, and commodity prices. Redrado lamented that the GoA had left it to the BCRA to explain the ramifications of the new and controversial capital repatriation law to skeptical U.S. and Financial Action Task Force (FATF) officials, but assured that the law's implementing regulations will require domestic banks to adhere to international anti-money laundering and counter-terrorism finance requirements. Redrado disagreed with market assessments that the GoA has undermined the BCRA's independence, arguing that the market has misinterpreted recent changes to the BCRA's charter to allow increased GoA borrowing from the BCRA as well as the BCRA's direct intervention in banks' currency trading operations to limit dollar sales and bolster the peso, which most observers believe is done on orders from GoA leadership. While the reality appears to be that the BCRA policy is increasingly influenced by the GoA, Post's financial sector contacts still largely support Redrado and want him to stay in the job. Ambassador also noted that Treasury will soon be ready to sign an agreement with the BCRA and GoA on establishing a technical assistance project in the area of terrorism finance. Regarding the G-20 process, Redrado said he and his team would do their best to assure a serious and productive Argentine participation in preparations for the April meetings. End Summary

2. (SBU) Ambassador met with Central Bank (BCRA) President Martin Redrado and BCRA Deputy General Manager of Economy and Finance Pedro Rabasa January 16 to review Argentina's economic outlook, new capital repatriation law, and the status of the Treasury OTA technical assistance project, and Argentine thinking on the upcoming April G-20 meeting.

Redrado: Managed Float Proves its Value

3. (SBU) Redrado called himself well satisfied with BCRA performance over the past two years in maintaining market confidence in the Peso in the face of four notable crises: August 2007 market turmoil at the start of the sub-prime crisis; deposit outflows during the March) July 2008 GoA confrontation with the agricultural sector over the GoA's efforts to impose higher and variable export tariffs; the flight to quality following the September 2008 Lehman Brothers bankruptcy; and the November 2008 deposit outflows that followed the GoA's announcement of its intent to nationalize private pension funds. The BCRA's ability to navigate these extraordinary challenges, Redrado said, demonstrates the effectiveness of its broad monetary policy and its managed peso float. Despite media speculation, constraints on BCRA actions don't come from the Casa Rosada (Pink House) seat of Executive power, equivalent to the White House), Redrado emphasized, but rather from Argentina's "mental dollarization" which has required the BCRA to boost domestic interest rates to staunch capital flight and retain local currency deposits. "We didn't invent the managed float concept," Redrado concluded, "but we have proven its effectiveness."

4. (SBU) Redrado discounted any pre-set value or margin for devaluation of the peso in 2009 (Futures markets currently put the peso's value at roughly 3.8 - 4.0 pesos/dollar at

year-end 2009.) Rather, the value of the Peso over the coming year will be determined by a host of market variables, including the Dollar/Euro cross-exchange rate, global interest rates, and the price of soy. "Tell me where these variables will stand at year-end 2009 and then I'll project a value of the peso for you," Redrado concluded.

Ensuring FATF-Consistent Capital Repatriation Law

15. (C) Redrado acknowledged that the BCRA had navigated a "difficult operating environment" in 2008, and said he expected to confront more convulsions ("cimbronazos") like the market's skeptical response to the GoA's capital repatriation law. "But, what doesn't kill you makes you stronger," Redrado joked. He lamented that few GoA officials understand how to talk to markets and said that it was left to his BCRA team to explain to Treasury Deputy Assistant Secretary for Terrorist Financing and Financial Crimes Danny Glazier that the new capital repatriation law would be regulated and managed in ways consistent with FATF anti-money laundering mandates. The BCRA is actively involved in drafting the law's implementing regulations, he said, and the BCRA has inserted "know your customer" language into (still in draft) regulations that will ensure repatriated capital is only flowed from international banks and to domestic banks that fully comply with FATF suspicious transaction protocols.

(Comment: Though their body language, both central bank officials indicated they did not expect this legislation to prompt a large amount of capital to rush back into Argentina.)

BCRA Sustaining Private Bank Profits, Liquidity

16. (SBU) The BCRA has successfully managed its reserve positions, buying and selling dollars "anti-cyclically" to moderate volatility in the peso, Redrado said. Beyond managing the peso exchange rate and the inter-bank rate to limit the withdrawal of deposits from spooked savers, the BCRA has demonstrated to banks that it is truly a lender-of-last-resort, using BCRA financial instruments to inject needed liquidity into the private banking system.

17. (SBU) The BCRA has sustained good working relations with Argentine private sector banks, Redrado said, demonstrating the BCRA's concern for private banks' need to both attract a stable deposit base and maintain bottom line profitability. Implicitly acknowledging significant central bank intervention in private bank foreign exchange trading during the last three months of 2008, Redrado said that, while private bank trading desks have an interest in "generating volatility" in order to create profitable trading and arbitrage opportunities, their corporate and consumer lending colleagues benefit from the kind of BCRA-managed currency stability that generates reliable deposit flows. As a result, BCRA had "talked to" the likes of Citibank to "explain the need for foreign exchange trading prudence.

18. (SBU) Post Comment: Beginning early November 2008 the BCRA assigned monitors to oversee banks' currency trading desks and various GoA regulatory agencies sent inspectors to both banks and exchange houses, with the purpose of using moral suasion and threats of tax audits to limit currency trading and deposit withdrawals. This tactic succeeded in preventing institutional depositors from dollarizing their accounts, and the resulting stabilization of deposit levels appears to have reassured retail depositors. While capital outflow continues, it is contained, and the BCRA has not been forced to continue large scale dollar sales to strengthen the peso and prevent deposit outflows. Based on Post's financial sector contacts, Redrado is correct in saying that bankers generally support these measures, even if they do not say so publicly. End Comment.

2009 Budget: BCRA Charter Change "Misunderstood"

¶9. (SBU) Ambassador asked about provisions of the 2009 budget law (Ref B) that market analysts -- including Goldman Sachs -- had reported as eroding central bank independence by allowing an expanded share of central bank reserves to be lent to the GoA Treasury. Redrado called this a mis-interpretation and explained that the 2002 revision of the BCRA charter limits general central bank short-term lending to the Treasury to 12% of the monetary base and limits lending to the Treasury for payment of IFI debt obligations to 10% of the previous 12 months' tax revenues. The 2009 budget law, he clarified, simply allows such funds

to be used to satisfy general GoA foreign currency obligations rather than restricting their use to IFIs.

¶10. (SBU) The change maintains the original spirit of the 2002 BCRA charter, Redrado said. The original law was drafted in a period where IFIs credits represented a more significant percentage of government funding, he said. Under the revised charter, BCRA funds can be used, he said, to repay Boden 2012s that will mature in August 2009. In any case, Redrado clarified, the change will be money-supply neutral. (This exchange has no monetary effect because the GoA will pay dollar-denominated bonds using dollars borrowed from the central bank, but these transactions will not increase the amount of pesos in circulation. If the central bank subsequently purchases these dollars back using pesos, it would need to sterilize the increase in the money supply by issuing debt instruments to mop up the extra pesos.)

2009 Challenges for BCRA

¶11. (SBU) Redrado called his primary concern in the coming year increasing unemployment and upcoming union salary negotiations. (Recent media reports have projected 2009 inflation in the 15-18% range and have noted that GoA officials hope to limit salary increases to the 12-13% range.) He acknowledged that the GoA's 7.2% "official" measure of 2008 inflation had little street credibility and that teamster union boss Hugo Moyano's statement that he would develop salary demands using a "housewives" inflation index augured for a new round of significant union salary increases that would further stoke inflationary expectations.

¶12. (SBU) Another challenge to be addressed in 2009 will be Argentine industry's need to access longer term financing. Argentina needs some type of long term bank on the model of Brazil's BNDES, Redrado said. He discounted using GoA second-story bank BICE for this end (Ref C), but suggested that the GoA was already addressing this issue by auctioning subsidized social security (ANSES) funds to commercial banks who promise to on-lend them longer term at competitive rates. "Private banks will take the credit risk, while ANSES takes the liquidity risk," Redrado said.

Treasury OTA Technical Assistance Project

¶13. (SBU) Ambassador noted that Treasury recently approved funding for the technical assistance project focused on terrorism financing with the central bank and GoA regulatory agencies. The next step will be to coordinate with the Central Bank and Justice Ministry on the Terms of Reference and finalize the Work Plan. Redrado agreed that a signing ceremony to highlight bilateral cooperation in this area would be appropriate and send welcome signals of bilateral cooperation to the incoming Obama administration.

G-20 Preparation

¶14. (SBU) Ambassador noted that this sources (U.S. and other G-7) indicated that Argentina's tone and substance at the first G-20 Summit in Washington had been quite distinct from the other 19, and that there could be a missed opportunity for Argentina if a more constructive approach was not evident in preparation for the April G-20 Summit. Redrado said he agreed fully on the need for a serious approach to this next opportunity to play a role in reshaping global financial practices and institutions. He said that he and his BCRA team would focus on playing a constructive role in the preparations process and in agreeing on documents with specifics for the next Summit. That would provide the base for more focused discussions among leaders, he suggested.

Comment

¶15. (C) Redrado repeated his standard defense of an Argentine central bank management that few local market players regard as truly independent. He acknowledged, however, that his room for maneuver has been constrained by the Kirchner administration's penchant for announcing new economic

initiatives with minimal consultation with the broader economic team, including the BCRA. "We are condemned by our history and our reputation for improvisation," Redrado said. In fact, GoA encroachment into the BCRA's area of authority over the last six months has been extensive. In addition to the 2009 budget bill's alteration of the BCRA charter to allow use of reserves to pay bilateral debts, the GoA also unilaterally announced in September 2008 its intention to use official reserves to pay Paris Club debts. It is accepted wisdom in the banking sector that the BCRA's direct intervention in currency trading markets in support of the peso is being conducted on direct orders from Nestor Kirchner, who reportedly opposed allowing the peso to depreciate. Despite his reduced independence, local bankers say they respect Redrado's skill at navigating the complex circumstances he faces. These same bankers frequently tell us that Redrado is the only Argentine official who understands their concerns and assert that the financial sector would be much worse off without him in charge at the central bank.

WAYNE